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# Beauty Will Save Georgia!

## Background

Georgia is a newly independent country well-known throughout the world for two major political figures: the first is Josef Stalin, who erected the Iron Curtain, and the second is Eduard Shevardnadze, who fought to bring that wall down. Unfortunately, the “Corruption Wall” in Georgia is still in place.

Corruption is probably the most frequently used word in the expatriate community in Georgia. It appears several times daily in almost all Georgian newspapers. The problem of corruption is not unfamiliar for any country, but especially so for Georgia, which has gone from a totalitarian regime to building a democratic society based on the rule of law quite recently.

Although under Russian domination and influence for most of the past two centuries, from 1918 to 1921 Georgia was an independent republic. In 1921, Georgia was officially incorporated into the Soviet Union and then once again became independent in April 1991. Since regaining its independence, Georgia has attempted to leave behind a totalitarian society and build a democratic society. Like other post-Soviet countries, Georgia faces several obstacles, including civil war, ethnic conflicts, and serious economic crisis.

Numerous statistics and publications report that the informal economy in Georgia is very large, at least responsible for 35 % of total economic activity. Some estimates put the figure well above that. The capacity of Georgians to profit from the shadow economy is nothing new and comes as an inheritance from the former Soviet regime, and regimes before that. Today, the growth of the informal economy and the current prevalence of corrupt practices represent the continuation of the informal economy and practices that flourished under Soviet rule. These activities and practices are prospering in the institutional vacuum that has resulted from the limited capacity of the government to perform its duties.

The large informal economy means that essential taxes cannot be collected. The main problem with collecting taxes is the government’s inability to collect those revenues and obstacles related to widespread corruption. The two factors together produce one of the worst collection rates for taxes owed among countries of the Former Soviet Union. As a

*“No responsibility of Government is more fundamental than the responsibility for maintaining the highest standards of ethical behavior by those who conduct the public business. There can be no dissent from the principle that all officials must act with unwavering integrity, absolute impartiality, and complete devotion to the public interest. This principle must be followed not only in reality but also in appearance. For the basis of effective government is public confidence, and that confidence is endangered when ethical standards falter or appear to falter.”<sup>1</sup>*

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<sup>1</sup> President Kennedy’s message to Congress on the subject of “Ethical Conduct in Government,” April 27, 1961.

result of these economic conditions, the U.S. Government agreed to assist Georgia with the comprehensive reform of the Tax Department. To better facilitate this reform, the Tax and Customs Departments were moved from the Ministry of Finance to a new ministry—the Tax Revenue Ministry of Georgia. The principles of reform and a detailed implementation plan were included into a memorandum of understanding signed by the Ambassador of the United States to Georgia, USAID, the U.S. Department of the Treasury (USDT) and the Minister of Revenue.

## Circumstances

Perhaps the United Nations Development Program *Human Development Report—Georgia 1999* captures the social and political climate in Georgia best:

*“Ten years have passed since Georgia’s independence, but the majority of the country’s population is poorer now than before. The average citizen does not feel secure. Many Georgians expected that independence would naturally make Georgia a prosperous, free-market democracy. Very few imagined that the transition from socialism to a liberal democratic state would last so long or be so difficult.*

*These high expectations may be attributed to the legacy of the Soviet mentality, which for years conditioned large sections of the population to expect that the state would provide for their needs.... Unfortunately, some aspects of the Soviet legacy apparently obstruct citizens’ perceptions of themselves as law-abiding individuals of a law-abiding state. . . . Government and enterprise are still fraught with dubious practices and nepotism. In extreme cases, cronyism and disrespect for the law transform a society of citizens and individuals into one of parents and children. E. Banfield refers to this extreme behavior as “amoral familism.”<sup>2</sup> Amoral familism fosters passivity, and antisocial and unproductive individualism. This type of individualism and its behavioral manifestations are often observed in societies that have been oppressed for long periods of time and whose citizens have developed an almost pathological distrust of government.*

*In these societies, the idea of examining the activities of public officials or establishing controls over them rarely crosses the minds of citizens. . . . The resulting mindset leads people to think, If I cannot change anything by myself, why should I act in a way different from others?”*

<sup>2</sup> Edward Banfield, *The Moral Basis of a Backward Society*, The Free Press/The University of Chicago, 1958.

## Assistance

Along with several other nations, the U.S. is assisting Georgia with building a democratic society. As part of this assistance, the United States Agency for International Development (USAID) and the USDT are providing technical and material assistance to the Tax Revenue Ministry of Georgia (TRMG). Almost everyone in Georgia will agree that revenue mobilization is at least half of the answer to improving the economic situation in Georgia.

A comprehensive reform program was developed and divided into nine major components: functional reorganization, human resources reform, training, computerization, internal control reform, compensation reform, taxpayer reform, tax code reform, and tax policy reform. The Implementation Plan included several points of principle to guide the reform efforts. Of particular note is the principle that the TRMG, including the OIG which is independent of but organizationally placed within the TRMG, can only afford to employ as many people as it can pay a living wage.

Low government salaries (about \$25 per month), and nonpayment of those salaries, is a problem that plagues all government service in Georgia. The Bureau of Statistics determined that the minimum monthly living wage for a family of four in Georgia is about 400 Lari (\$200). Working with Georgian counterparts, the advisors for the reform established reasonable salary levels for the TRMG—the lowest salary being equal to the minimum living wage—while taking into account the current economic circumstances. The funding of salaries comes from an amendment to the Tax Code of Georgia adopted in September 1999. This provision establishes a three—percent incentive fund for the TRMG and its substructures. A special account was established and three percent of all taxes collected are earmarked for the TRMG, with the remainder going to the central and local budgets.

While this incentive fund is considered very poor budget policy, it is impossible to expect sustainable reform and a reduction in corruption without payment of a living wage. The number of persons the TRMG could afford to employ was determined by multiplying three—percent times the historical collections from previous years and dividing that number by the average salary, allowing for 40% overhead. A 40% overhead rate is very low but probably sufficient for Georgia since USAID is funding all computerization and initial telecommunications costs (about \$2 million). The OIG will also be connected to this computer network and have ready access to TRMG information.

The incentive budget and increased salaries met with great resistance from Georgians in the TRMG, Tax Department, and from other arms of the government. They have not broken the chains that bind them to their Soviet past. Additionally, several other government organizations put forth their proposals to establish similar incentive budgets. While this funding mechanism worked successfully for tax reform in other countries, it is doubtful that such a mechanism should be adopted government-wide. The TRMG is an exception—it plays the key role in mobilizing revenue

to the budget. Healthy revenue collection will provide for a sound budget and hence the resources for necessary expenditures. Sustainable reform has to begin somewhere, and the TRMG is a logical starting point.

In January of 2000, the USDT sent a resident advisor to Georgia to assist with internal control reforms in the TRMG. The advisor's first order of priority was to participate on a joint task force of Georgians and expatriate advisors assembled to draft an implementation plan for the overall tax reform project. USAID and its contractor, as well as the USDT, had already been working on tax reform for over two years, but without an integrated reform plan. The task force met for three weeks and developed a detailed plan that became part of the memorandum of understanding between the Governments of Georgia and the U.S. signed on March 8, 2000.

As a provision of the implementation plan, the USDT advisor provided the Minister of Revenue with a concept paper on internal control. This paper was designed to help the Minister better understand the roles of management and an oversight organization. The concept paper presented basic information on internal control and management accountability, and discussed organizational options for an oversight body. The two basic options presented to the Minister were an Internal Audit Division and an Office of Inspector General (OIG). The Minister embraced the concept of an OIG.

On June 30, 2000, the OIG for the TRMG was established by Presidential Decree #280. The two major subunits of the TRMG, the Tax and Customs Departments, had Internal Control Divisions which were not functioning properly and were abolished. The employees of both divisions were dismissed and only three were re-hired by the new OIG. After creation of the TRMG in December 1999, organizational change for the two Internal Control Divisions was inevitable since neither could be responsible for providing oversight to the newly created TRMG. In contrast, the new OIG provides oversight to the Ministry and all of its substructures.

In July 2000, the President of Georgia appointed the first IG for the TRMG, Badri Abzianidze. As the USDT advisor's counterpart, the advisor and IG worked cooperatively to establish the IG organization. The IG chose his staff very carefully; most of the employees had prior experience with the Anti-Corruption Commission at the Parliament, or with the Anti-Corruption Research Center. Unfortunately the basis for the new OIG is a Presidential Decree, not legislation. Because the key legislative component was absent, the OIG and advisor drafted an organizational charter to serve temporarily as the basis for the OIG's activities. The charter was approved by the Ministry of Justice and adopted by the OIG in early fall.

The organization of the OIG is similar to those in the U.S., having two basic functions: audit and investigations (called "inquiries" in Georgia). In November 2000, the USDT advisor and a delegation of eight Georgians (five from the OIG) visited the U.S. on a study tour to have a

first-hand look at the IG model they adopted. Among others, the Treasury Inspector General for Tax Administration, the U.S. General Accounting Office, the Internal Revenue Service, and the U.S. Customs Service hosted the delegation.

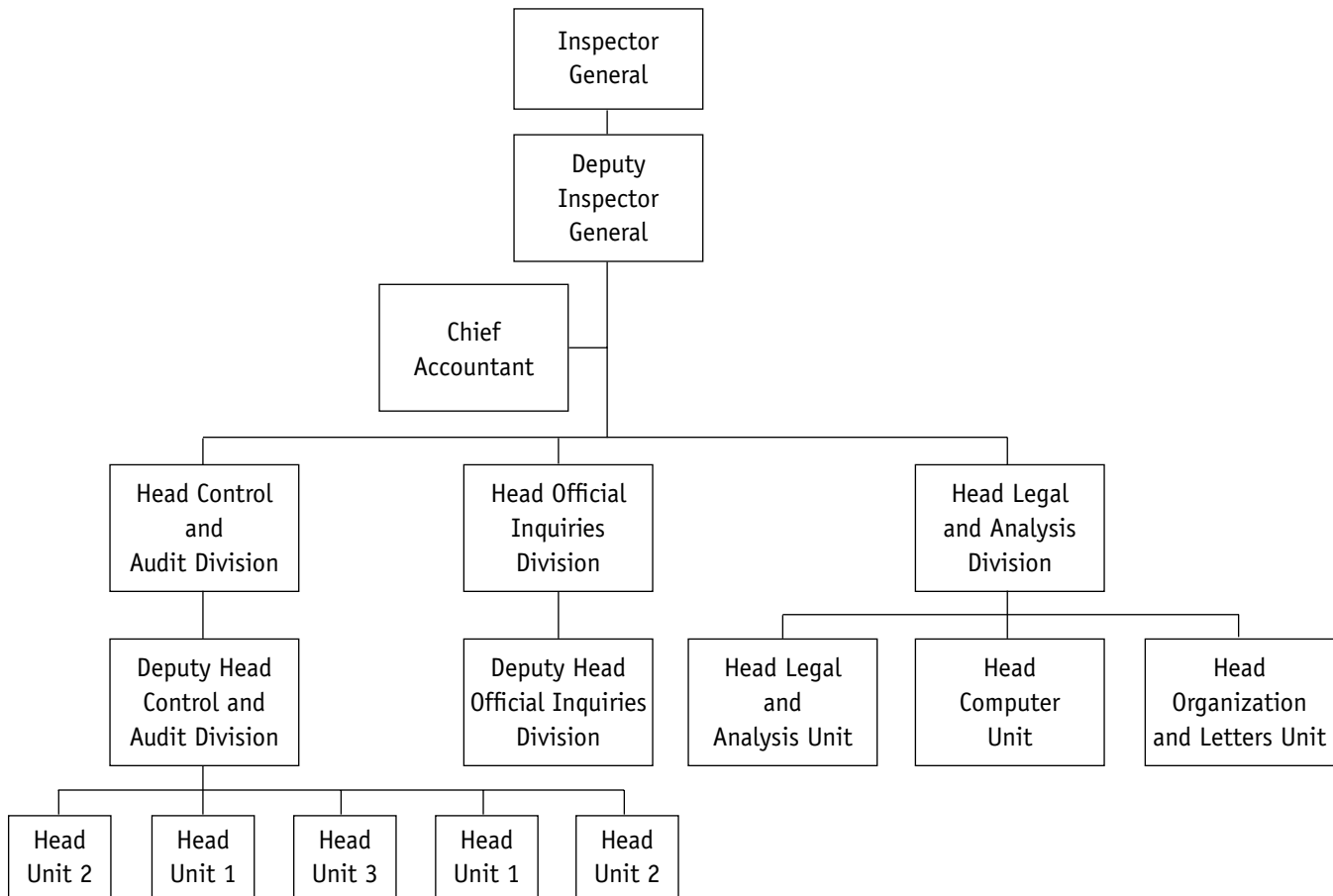
As a result of the study tour, the Minister of the TRMG and the IG invited the Treasury Inspector General for Tax Administration (TIGTA) to visit Georgia. In April 2001, the IG came to Georgia on his first official visit. During his visit, the IG met with the staff members of the OIG, Members of the Parliament, the State Minister, the Minister of the TRMG, the U.S. Ambassador to Georgia, and officials from USAID. At the end of his visit, the TIGTA and IG signed a Cooperation Agreement between their two services. This is the first time such an agreement has been established between a U.S. OIG and a foreign counterpart. The agreement provides for exchange of information and experience between the two services and will serve as a vehicle to facilitate future cooperation.

One year has passed since its creation. In that short period of time, the OIG has achieved significant results. During its first major audit of Value Added Tax (VAT), the OIG identified about 10 million Lari (\$5 million) in questionable VAT offsets and refunds. This amount is significant since current estimates put VAT fraud at over \$50 million per year. During another audit, the OIG noted that Customs prices for imported automobiles were unrealistically low since the adoption of pre-shipment inspection in September 1999. Since implementation of pre-shipment inspection, all vehicles imported through one major customs facility were valued below the pre-shipment inspection threshold of \$5,000 and no vehicle cleared by the customs station ever had an accompanying import tax payment certificate.

The OIG achieved similar results from official inquiries. Approximately 25 employees were dismissed from the TRMG during the past 12 months based on the results of the OIG's inquiries. Employees were dismissed for mismanagement and dereliction of duty, taking bribes, and for falsifying university diplomas.

While the OIG has achieved significant results, many challenges still lie ahead. The Government of Georgia must establish a strong legislative basis for the OIG and provide the OIG with the appropriate authorities to achieve its objectives. This is a politically challenging issue. Currently criminal inquiry and investigative authorities belong to other government organizations, such as the Procuracy (*Attorney General*), the Ministry of Interior, and the Ministry of State Security. These other organizations are commonly known as "power ministries" and decentralization of their authorities has met with strong resistance, with political forces being hard at work to prevent the transfer of these authorities to the OIG. Without these authorities the effectiveness of the OIG's efforts is diminished since the Official Inquiries Division's work is limited to identifying and investigating administrative violations. In spite of these limitations, the OIG successfully achieved results from their inquiries.

## Office of Inspector General for the Tax Revenue Ministry of Georgia



The OIG is just one beacon of light in the fight against corruption, a struggle that Georgia will grapple with for many years to come. While TRMG employees have been removed for such things as bribery and lying, the “big fish” still remain outside the net. After the IG catches some of these fish, Georgia may begin to see truly meaningful reform. The real challenge for the IG is facing extreme difficulties trying to root out corruption at the highest levels in a society and culture where corruption is the norm.

In addition to the lack of criminal inquiry and investigative authorities, Georgia lacks government-wide auditing standards. The USDT advisor and USAID are working with the Supreme Auditing Institution of Georgia to establish appropriate standards and provide training on those standards. In conjunction with USAID’s other reform efforts, the advisors have urged the Government of Georgia to adopt the auditing standards developed by the International Organization of Supreme Auditing Institutions (INTOSAI). It is premature for Georgia to adopt its own auditing standards that would differ from internationally recognized standards and principles. Children must learn to walk before they can run.

## Prognosis

The creation of an OIG for the TRMG is a step in the right direction but the OIG is only one small part of the massive change that needs to take place. In the middle of last year, a story entitled “Beauty Saves Georgia” appeared in the daily English newspaper, *The Georgian Times*. The story and accompanying picture were about the first Miss Georgia beauty pageant. The headline of the story applies to more than just the Miss Georgia pageant. Beauty is probably what will really save Georgia from its economic and political ruin.

Although Georgia is a small country, about the size of West Virginia with a population around 5.5 million, it has great natural and human resources. Georgia has a long history of surviving conflict and invasion. Mother Georgia represents this survival. High above Tbilisi, the capital of Georgia, stands an aluminum statue of Mother Georgia. In her right hand Mother Georgia holds a wine goblet to welcome her friends. In her left hand she holds a sword, to protect her people and slay her enemies. It is the beautiful combination of this hospitality and strength of national character that will save Georgia. 🇯🇵